

TEACHERS' RETIREMENT BOARD
SUBCOMMITTEE ON CORPORATE GOVERNANCE

SUBJECT: Review of Statement of Investment Responsibility

ITEM NUMBER: 5

ATTACHMENT(S): 1

ACTION: _____

DATE OF MEETING: March 6, 2002

INFORMATION: X

PRESENTER(S): Janice Hester Amey

EXECUTIVE SUMMARY

The Statement of Investment Responsibility (SIR) was adopted by the Teachers' Retirement Board (TRB) in 1978, bringing its known tenure to 23 years. The SIR, along with the Financial Responsibility Criteria for Corporate Investments are the two decision-making documents that guide the Corporate Governance Program at CalSTRS. The over-riding objective of the Corporate Governance Program has been to enhance shareholder value, "non-financial or collateral benefits notwithstanding."¹ The Chief Investment Officer has been delegated authority to manage the Corporate Governance Program.

The SIR has been reviewed annually, since its adoption, but very few changes have been made over recent years. The document has not been modified since 1997. The document is organized into five sections:

- **Philosophy**-This is where the fiduciary duty responsibility of the TRB is explained or stated: "It is the fiduciary responsibility of the Board of the State Teachers' Retirement System to discharge its responsibility in the interest of the participants and beneficiaries..."
- **Principles**-This is where the overall investment policy is explained: "The preservation of principal and maximization of income will clearly be the primary and underlying criteria for the selection and retention of securities." This section also explains the TRB's concern for basic human rights and dignities.
- **Selecting New Investments**-This section explains that social responsibilities will not drive the investment policy of CalSTRS: "Investments shall not be selected or rejected based solely on social responsibilities."
- **Exercise of Shareholder Rights**-This section details the duty that CalSTRS has to exercise its proxy power: "The System has a duty to cast its votes on all proxy issues related to companies in which it holds securities...will actively vote its proxies..."

¹ Corporate Governance Program

Adopted by the Investment Committee October 13, 1999

- **Sanctions**-This section discusses the steps that CalSTRS may take if/when its efforts to 'correct practices' with corporations fail: "When the remedies provided in B (above) indicate that there is little or no possibility of obtaining from a company a commitment to pursue activities designed to correct practices or policies involving grave social injury, the Board should consider either making no new investments or divestment if consistent with sound investment practice."

The SIR is included with this item as Attachment 1. It is presented for information and review purposes. Staff is not recommending any changes at this time.

STATE TEACHERS' RETIREMENT SYSTEM STATEMENT OF INVESTMENT RESPONSIBILITY

I. Philosophy

The Teachers' Retirement Board finds that:

It is the fiduciary responsibility of the Board of the State Teachers' Retirement System to discharge its responsibility in the interest of the participants and beneficiaries and for the primary purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the System; the investment policy of the System should reflect and reinforce this purpose.

Public retirement systems operate in a unique and complex social-economic milieu, providing for substantial disclosure of their operations and investment activity and placing them in a position where they should be above that of the private sector in social responsibility activities.

The System's responsibility extends to its participants and beneficiaries and to the general public. In addition to its fiduciary responsibilities to its members, the Board has the social and ethical obligation to require that corporations in which securities are held meet a high standard of conduct in their operations.

The act of investment in the securities of a corporation predominantly reflects a judgment that the ownership will produce a rate of return which will make it an attractive investment. While not outwardly signifying approval of all of a company's policies and products, it is possible however that such investment may be interpreted as an indication of the shareholders approval or support of all of a company's policies and products.

The System is a large investor and as such, is in a position to exert influence on the corporations in which it has invested.

II. Principles

Consistent with these findings, the System establishes the following principles to govern the development of a responsible investment policy:

A. Preservation of Principal and Maximization of Income

The preservation of principal and maximization of income will clearly be the primary and underlying criteria for the selection and retention of securities.

B. Non-Economic Factors

Non-economic factors will supplement profit factors in making investment decisions. Non-economic factors are defined as those considerations not directly related to the maximization of income and the preservation of principal. The consideration of non-economic factors is for the purpose of ensuring that the Retirement System, either through its action or inaction, does not promote, condone or facilitate social injury.

C. Social Injuries Defined

Social injury will be said to exist when the activities of a corporation serve to undermine basic human rights or dignities. Basic human rights and dignities include, but are not limited to:

1. Equal Employment

Equal employment opportunity, including: fair and equitable recruitment and hiring, equal wages and benefits for equal and comparable worth, fair and equitable promotional and training opportunities, and the right to organize and join representative trade unions and associations if a majority of the employees so elect.

2. Housing

Equal access to safe and decent housing.

3. Basic Services

Equal access to basic services including medical care, transportation, recreation and education.

D. Corporate Practices

Social injury may also be said to exist when the Board, having followed the procedure set forth in Section IV.C.2, perceives that it is the prevailing belief of the members of the Retirement System that the practices of a corporation result in undesirable side effects for others, and that the side effects are grave in nature. Side effects which may be deemed grave in nature shall include, but not be limited to:

1. Environmental

Practices which are known to endanger the environment, subject to current federal, state and local law, including:

- a) Unsafe nuclear waste disposal;
- b) Ineffective or inadequate pollution control; or
- c) Improper use of chemicals and contaminants; or
- d) Any practice which directly or indirectly endangers human health or the environment.

2. Suppression of Human Rights

Practices which result in the suppression of human rights including:

- a) The sale of weapons and technology to governments known to engage in the systematic suppression of human rights; and
- b) The sale or purchase of goods from countries known to employ forced labor.

3. Human Health

Practices which endanger human health including:

- a) Sale and distribution of known contaminated products;
- b) Sale and distribution of therapeutically ineffective or dangerous drugs; and
- c) Purchasing goods from or selling goods to companies known to disregard worker safety.
- d) A company should not be held responsible for the infliction of social injury merely by virtue of its agreements or relationships with other (independent) entities engaged in socially injurious activities.

E. STRS Involvement

The extent of the responsibility of the System to engage in activity for the prevention, reduction, and elimination of social injury should be determined by:

- The number of shares held in the corporation;
- The gravity of the social injury.

In support of the aforementioned principles, the System sets forth the following guidelines for social responsibility in investments.

III. Selecting New Investments

In selecting new investments for the System, the Board adopts the following guidelines for both domestic and international investments.

- A. Investments shall not be selected or rejected based solely on social responsibilities.
- B. Social factors shall be taken into consideration to that such factors bear on the financial advisability of the investment; e.q., not investing in a corporation whose conduct has had a demonstrated negative effect on the corporation's financial viability.
- C. Generally, social criteria, to the extent available, should be considered after all financial criteria have been satisfied.

IV. Exercise of Shareholder Rights

A. Proxy Voting

- 1. The System has a duty to cast its votes on all proxy issues related to companies in which it holds securities or to abstain with written notification to the company involved on any proxies it returns. In cases of

abstention, where an important social responsibility issue is raised, the System should provide an explanation of its action.

Statement of Investment Responsibility

2. The System should vote its shares in favor of resolutions which, if implemented, would prevent, reduce, or eliminate social injury as defined above. The System should oppose resolutions which cause or facilitate social injury.
3. If a resolution places a company at a substantial disadvantage with respect to its direct competitors who are equally guilty of inflicting social injury, the System should ascertain whether the company in question has made reasonable effort to induce voluntary industry-wide compliance. If it is determined that this course of action has been pursued, the System should abstain. In the event that a corporation has not initiated such activity, the explanation accompanying abstention should include an exhortation for compliance.
4. The State Teachers' Retirement System, as a major corporate shareholder, will actively vote its proxies to elect corporate board members who share the interests and philosophy of the System.
5. The System should routinely monitor corporate practices for compliance with the Board's criteria, i.e., monitor corporate compliance with the Sullivan principles'.

B. Other Shareholder Rights

1. For the purpose of insuring that a company may be made aware of any policies, procedures, or products of which the Board does not approve, and for the purpose of prevention, reduction or elimination of social injury, the Board may initiate action to supplement the responsible voting of proxies including but not limited to: (a) correspondence with the company, (b) meet and confer sessions with management or other stockholders, (c) entering into agreements with management or other stockholders, such as making provisions for reporting and other monitoring activities, and (d) the initiation, when determined necessary, of shareholder proposals.

C. Procedure

1. Responsibility for the implementation of social responsibility guidelines is delegated to the Board's Investment Committee. Ultimate authority and responsibility rests with the Board.
2. To assist the Board in determining whether social injury exists, the Board should:
 - a. Upon request, permit the presentation of relevant testimony by members of the System and members of the general public during Board meetings;

- b. Establish contact with appropriate regulatory agencies, such as Equal Employment Opportunity Commission, Environmental Protection Agency, Occupational Safety and Health Agency, Nuclear Regulatory Commission, Securities Exchange Commission, and others which are covered by laws of the United States Government or the State of California;
- c. Contact qualified persons representing parties affected by the corporate practice in question.

V. **Sanctions**

- A. When the remedies provided in B (above) indicate that there is little or no possibility of obtaining from a company a commitment to pursue activities designed to correct practices or policies involving grave social injury, the Board should consider either making no new investments or divestment if consistent with sound investment practice. Factors contributing to such a determination include, but are not limited to:
 - 1. Repeated refusal by management and a majority of stockholders to support shareholder proposals which the Board feels are necessary to insure socially responsible behavior;
 - 2. Failure of management to comply with Board requests for the disclosure of economic or non-economic information important to making investment decisions, in particular, information pertaining to company practices and policies which might result in social injury.
- B. A company committing social injury should not be subject to consideration for divestment if it is determined that the company is engaged in socially beneficial activity, where the resulting benefits are held to be greater than the injury. However, it is not the intention of this paragraph to imply a condonation of the social injury, nor does it preclude the exercise of shareholder rights in an effort to reduce such injury.

ADOPTED BY THE TEACHERS' RETIREMENT BOARD JUNE 16,1978

REVISED BY THE TEACHERS' RETIREMENT BOARD SEPTEMBER 24,1982

REVISED BY THE TEACHERS' RETIREMENT BOARD APRIL 27, 1984

REVISED BY THE TEACHERS' RETIREMENT BOARD APRIL 21, 1989

REVISED BY THE TEACHERS' RETIREMENT BOARD JANUARY 9, 1990

REVISED BY THE INVESTMENT COMMITTEE NOVEMBER 5, 1997

